purchase AMD chips for its computers, which would mean the loss of those hundreds of millions of dollars of rebate/kickback payments from Intel, which would hurt Dell's operating profits and margins.

(n) The Dell Direct business model was not advantaged in all environments across all regions and in all product categories or able to cause Dell to report solid profits and rapid growth regardless of prevailing market conditions due to product quality and customer service and support issues due to the deficiencies and defects detailed above.

(o) Dell's purported improvements in reducing its operating expenses as a percentage of net revenues and the reported increases in its net and gross operating profit margins to record high levels were only being achieved at the cost of the serious product quality and customer support and service problems outlined above and which the Dell Defendants knew would require massive expenditures to fix, harming Dell's profitability going forward.

(p) Due to the material adverse facts and problems set forth above, Dell and the Dell Defendants knew that Dell could not and would not achieve the revenue, operating profit, operating profit margins, net income and EPS growth being forecast by them.

117. During the first half of 3/05, information became public that Intel was violating the antitrust laws by paying huge kickbacks to customers (computer manufacturers) to get them to buy microprocessor chips only from Intel. For instance:

(a) On 3/4/05, Japanese regulators had determined that Intel was violating Japan's antitrust laws by paying secret rebates, *i.e.*, kickbacks, to Japanese computer manufacturers in return for their purchasing microprocessors exclusively from Intel. A report stated:

> Japan's Fair Trade Commission will rule against a local unit of the world's leading microchip maker Intel Corp. over suspected violation of anti-monopoly laws, a report said Friday.

> Intel has been under investigation on allegations that it pressured its customers to limit their procurement from rival firms in exchange for discounts on Intel products.

(b) On 3/7/05, the *San Jose Mercury News* reported on the Japanese antitrust proceeding against Intel:

> **Japan reportedly accuses Intel of antitrust violations**
>
> Japanese newspapers are reporting Japan's government has found Intel in violation of the country's antitrust laws.
>
> * * *
>
> Yomiuri Shimbun reported that the agency found Intel offered discounts on is microprocessors to computer makers in Japan provided they agreed to limit purchases of chips from competing manufacturers.

(c) On 3/8/05, it was reported that the Japan Fair Trade Commission ("JFTC") had ordered Intel to cease and desist conduct which violated Section 3 of the Antimonopoly Act (Private Monopolization). According to the JFTC, ***since 5/02, Intel had paid the five major Japanese computer OEMs rebates and/or certain funds referred to as "MDF" (Market Development Funds) on the condition that the Japanese OEMs purchase 100% of their microprocessors from Intel and refrain from adopting competitors' microprocessors***. From these reports, it appeared that Intel did not contest the charges of the JFTC and that Intel's illegal kickback payments to its customers in Japan would cease.

118. As Dell was known to purchase 100% of its microprocessor/chip requirements from Intel, Dell's stock fell from $40.93 on 3/4/05 to $38.02 by 3/18/05, a decline of over $7 billion in market capitalization, which damaged prior Class Period purchasers of Dell's stock, who purchased at higher, inflated prices.

119. Dell's F05 10-K was filed with the SEC on or about 3/8/05. It was signed by M. Dell, Carty, Miles, Rollins and Schneider, and contained Dell's F05 financial results and statements as audited and certified by PWC. The 10-K stated:

Manufacturing and Materials

Dell manufactures most of the products it sells . . . .

Dell's manufacturing process consists of assembly . . . functional testing, and ***quality control. Testing and quality control processes are also applied to components, parts, and subassemblies obtained from third-party suppliers. Quality control is maintained through the testing of components, subassemblies, and systems at various stages in the manufacturing process. Quality control also includes a burn-in period for completed units after assembly, on-going production reliability audits, failure tracking for early identification of production and component problems, and information from Dell's customers obtained through services and support programs.*** . . .

. . . Dell currently relies on Intel Corporation as a sole source supplier of processors . . . . These relationships and dependencies have not caused material disruptions in the past, and ***Dell believes that any disruptions that may occur would not disproportionately disadvantage Dell relative to its competitors.***

* * *

The following table summarizes Dell's consolidated results of operations for each of the past three fiscal years:

Fiscal Year Ended
(dollars in millions)

	1/28/05	% Change	1/30/04	% Change	1/31/03
Net revenue	$49,205	19%	$41,444	17%	$35,404
Gross margin	$9,015	19%	$7,552	19%	$6,349
% of net revenue	18.3%		18.2%		$17.9%
Operating expenses	$4,761	19%	$4,008	14%	$3,505
% of net revenue	9.7%		9.7%		9.9%
Operating income	$4,254	20%	$3,544	25%	$2,844
% of net revenue	8.6%		8.6%		8.0%
	*	*	*		
Net income	$3,043	15%	$2,645	25%	$2,122
% of net revenue	6.2%		6.4%		6.0%

* * *

Dell's superior execution in all product and service offerings has been demonstrated by progress in customer satisfaction ratings during the year, which is a key performance metric for the company.

* * *

Gross Margin

Gross margin as a percentage of net revenue improved slightly to 18.3% during fiscal 2005, compared to 18.2% [in] fiscal 2004 and 17.9% in fiscal 2003. The year-over-year improvement during fiscal 2005 and 2004 was primarily driven by Dell's continued cost savings initiatives. . . . ***As part of management's focus on improving margins, Dell remains committed to reducing . . . manufacturing costs, warranty costs . . . and overhead or operating expenses. These cost savings initiatives also include providing certain customer technical support . . . functions from cost effective locations . . . . Management believes that the strength of Dell's direct business model . . . makes Dell better positioned than its competitors to continue profitable growth in any business climate.***

120. Dell's F05 10-K also discussed Dell's accounting policies:

Critical Accounting Policies

Dell prepares its financial statements in conformity with generally accepted accounting practices in the United States of America ("GAAP"). . . . ***Dell believes its most critical accounting policies relate to revenue recognition, warranty accruals, and income taxes.***

* * *

Warranty – Dell records warranty liabilities at the time of sale for the estimated costs that may be incurred under its basic limited warranty. . . . Warranty claims are relatively predictable based on historical experience of failure rates. Each quarter, ***Dell reevaluates its estimates to assess the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.***

121. In or about 4/05, Dell issued its F05 Annual Report. It included a letter from M. Dell and Rollins which stated:

Our fiscal 2005 was distinguished by ***best-ever operating results*** . . . .

Our . . . revenue [and] operating profit . . . were all company records. . . . Operating income rose 20 percent to $4.3 billion, representing 8.6 percent of revenue, our highest rate in four years. . . .

Dell's exceptional performance again demonstrated the . . . superb execution of a better way of doing business . . . . Our business is a model for customer focus, growth and profitability. We ended the year well ahead of our plan to achieve annual revenue of $60 billion by the end of fiscal 2007. . . .

* * *

And we're winning the right way, with a high level of integrity . . . .

* * *

Customer Experience

Product leadership helps attract new customers to Dell. But their subsequent experience is critical to returning again and again for their technology needs.

Meeting unique customer requirements is our responsibility and commitment. . . . [T]hose requirements follow simple themes: provide quality products and services, resolve issues when they arise, and show customers how highly they're valued at Dell. For each of those areas, we persistently track and act in response to how customers say we're performing against a variety of specific standards.

122. Elsewhere, the F05 Annual Report stated:

Dell is studied by customers worldwide for its expertise in manufacturing. . . .

* * *

Process improvements benefit Dell and customers through lower costs, ***better quality and better overall customer experience.***

123. The F05 Annual Report contained Dell's recent financial results:

Operating Results
(in millions, except per share data)

Fiscal-Year Ended	**1/28/05**	**1/30/04**	**1/31/03**	**2/1/02**	**2/2/01**
Net revenue	$49,205	$41,444	$35,404	$31,168	$31,888
Gross Margin	$9,015	$7,552	$6,349	$5,507	$6,443
	*	*	*		
GAAP operating income	$4,254	$3,544	$2,844	$1,789	$2,663
Pro-forma net income	$3,323	$2,645	$2,122	$1,780	$2,310
GAAP net income	$3,043	$2,645	$2,122	$1,246	$2,177
	*	*	*		
GAAP earnings per common share	$1.18	$1.01	$0.80	$0.46	$0.79

Percent of Net Revenue

Fiscal-Year Ended	**1/28/05**	**1/30/04**	**1/31/03**	**2/1/02**	**2/2/01**
	*	*	*		
GAAP Operating Income	8.6%	8.6%	8.0%	5.8%	8.4%

124. On 4/7/05, Dell held its annual Analyst/Investor Meeting, during which the following occurred:

> **[Rollins – CEO:]** . . . ***[T]he model is performing well, the model is solid . . . [and] will continue to be very successful.***
>
> * * *
>
> **[Schneider – CFO:]** . . . ***I'm always really proud to be able to talk to you about our financial aspects of the business because it's been such a great story for us. . . . [R]ight now, we're probably better positioned, financially than we certainly have been in any other point in time in this company's life.***

125. On 4/7/05, Bear Stearns issued a report on Dell based on the analyst meeting, reporting what had been said there:

> **Dell Inc. – Outperform . . . Confident About Growth Prospects; Maintaining Estimates And Outperform Rating**
>
> * * *
>
> ***Dell was confident about its prospects to drive growth during its analyst day*** . . . .
>
> * * *
>
> **Key Takeaways from Analyst Meeting:**
>
> - . . . [C]onfident about growth prospects. . . . CEO Rollins came across confident about Dell's ability to drive growth . . . .
> - ***Dell's Model thrives in a slow-growth environment. Though CEO Rollins signaled a more cautious environment, he noted that Dell's growth tends to be faster in periods of slower market growth given its low-cost, share gain model.***

126. On 5/12/05, Dell reported very strong and ***record*** 1stQ F06 results via a press release stating:

> Dell continued to grow significantly faster than the rest of the industry in all global regions, customer segments and product categories during its fiscal first-quarter 2006, ***and did so with strong profitability***.
>
> * * *

For the quarter ended April 29, the company achieved total revenue of \$13.4 billion, a 16-percent increase year-over-year, and net earnings of 37 cents per share, up 32 percent and a company ***record***.

		1stQ	
(in millions, except share data):	**FY '06**	**FY '05**	**Change**
Revenue	\$13,386	\$11,540	16%
Operating Income	\$1,174	\$966	22%
Net Income	\$934	\$731	28%
EPS	\$.37	\$.28	32%

127. On 5/12/05, Dell held a conference call for analysts, money managers and institutional investors concerning its 1stQ F06 results and its business. During the call, the following occurred:

> [**Schneider – CFO:**] Once again we grew profitably . . . . Our results reaffirm the strength of the model . . . allowing us to continue to outperform the industry.
>
> . . . [W]e delivered EPS of \$0.37, an increase of 32% year-over-year on \$13.4 billion in revenue. ***Our operating profit grew 22% year-over-year to \$1.2 billion. Operating margin was 8.8%, up 40 basis points year-over-year . . . .***
>
> *   *   *
>
> [**Rollins – CEO:**] This environment is ideal for our model and plays to the strength of our strategy.
>
> *   *   *
>
> ***Dell's model continues to deliver the exceptional . . . operating results in any environment.***

128. On 5/12/05, Bear Stearns issued a report on Dell based on the recent conference call. It stated:

> Dell again stood a cut above the rest, delivering in-line results with robust growth . . . . ***We're raising our ests*** . . . .
>
> *   *   *
>
> - **Gross Margin Above Expectations.** Gross margin of 18.61% was above our forecast of 18.46%, up 7 basis points sequentially and 65 basis points from the year-ago period . . . .
>
> *   *   *

- For FY06, we are ***raising*** our EPS estimate from $1.55 to $1.60 . . . .

- For FY07, we are ***raising*** our EPS estimate from $1.80 to $1.90 . . . .

129. On 5/13/05, *Bloomberg* reported:

Shares of Dell Inc., the world's largest maker of personal computers, rose 4.5 percent after the company said first-quarter profit ***increased 28 percent*** . . . .

* * *

[Dell expanded] its first-quarter profit margin to 8.8 percent from 8.4 percent . . . .

* * *

Dell's shares advanced $1.65 to $38.26 at 10:06 a.m. . . .

Rollins, who took over as CEO from company founder Michael Dell last July, told reporters on a call yesterday ***he's "confident and optimistic"*** and Dell is seeing "***healthy" demand*** . . . .

130. On 5/13/05, PacificCrest issued a report on Dell based on the recent conference call which stated:

Renewed Confidence in Profitable Growth Prompts Upgrade

* * *

The gross margin improved to 18.6% from less than 18% in the prior year; it reached the highest level in four years.

. . . We are upgrading Dell . . . .

* * *

The most surprising element of the quarter was the upside in the gross margin, [due to] declines in component costs.

131. On 5/13/05, Deutsche Bank issued a report on Dell based on the recent conference call. It stated:

Gross margins of 18.6% were 10bps above our estimates. . . . ***Essentially, we believe Dell enjoyed better margins in Consumer due the favorable component environment.*** . . . EPS was $0.37 in the quarter . . . .

132. On 6/3/05, Dell filed its 1stQ F06 report on Form 10-Q with the SEC, signed by Joan S. Hooper ("Hooper"), Dell's CAO. It contained the same financial results earlier reported and stated:

> [W]e delivered ***strong operating results*** and strengthened our financial position.
>
> * * *

	Three Months Ended				
	4/29/05		4/30/04		
	Dollars	% of Revenue	Dollars	% of Revenue	% Change
	(in millions, except per share amounts and percentages)				
Revenue	$13,386	100.0%	$11,540	100.0%	16%
Gross Margin	2,491	18.6%	2,073	18.0%	20%
Operating expenses	1,317	9.8%	1,107	9.6%	19%
Operating income	1,174	8.8%	966	8.4%	22%
Net income	934	7.0%	731	6.3%	28%
Earnings per share – diluted	0.37	N/A	0.28	N/A	32%

> * * *
>
> Dell's gross margin as a percentage of revenue increased to 18.6% during the first quarter of fiscal 2006, compared to 18.0% during the first quarter of fiscal 2005. Our year-over-year improvement in gross margin is due to favorable pricing on certain commodity components .... The strength of our direct-to-customer business model . . . position[s] us to pursue share gains in any business climate. As part of our focus on improving margins, we remain committed to reducing . . . manufacturing costs [and] warranty costs . . . . Cost savings initiatives include providing certain customer technical support . . . from cost-effective locations . . . .

133. The statements made between 3/05 and 6/05, as pleaded above, included:

- Dell was reporting "***strong profitability***" and "***record***" results – which were being achieved with a "***high level of integrity***," leaving Dell "***better positioned financially than in any other point in time***."

- Dell's model was "***solid***" and "***performing well***," with "***superior execution in all product and service offerings***," resulting in "***exceptional operating results in any environment***," "***demonstrated by progress in customer satisfaction – a key performance metric for the company***."

- "***The strength of [Dell's] direct business model makes Dell better positioned than its competitors to continue profitable growth in any business climate***" and Dell "***will continue to be very successful.***"

- Dell's top officers had reviewed Dell's internal financial and accounting and disclosure controls. Those controls were effective to assure accurate preparation of Dell's SEC filings and that no undisclosed deficiencies in Dell's internal controls or fraud – material or otherwise – existed at Dell.

These statements impacted and were reflected in the market trading price of Dell stock. The statements set forth in ¶¶119-133 were false and misleading. The true undisclosed facts, which were known to or recklessly disregarded by each of the Dell Defendants, were:

(a) The Dell Direct business model was not operating successfully or creating the strong, often record, financial results and operating margins Dell was reporting; in fact, due to overly aggressive cost-cutting in Dell's customer support and service and manufacturing operations, Dell's business model was being afflicted with sky-rocketing customer dissatisfaction and complaints, as well as increasing product quality problems (especially with laptop batteries and capacitors). In truth, Dell's financial results were being falsified and temporarily inflated by (i) large cost-cuts which would have to be reversed and remediated; (ii) improper accounting tricks, including under-accruing warranty costs and failing to take timely write-downs for defective products and product replacement; and (iii) its secret receipt of some $200 million per quarter in rebate/kickback payments from Intel in return for exclusively purchasing Intel microprocessors/chips.

(b) Dell was not manufacturing or selling the highest quality products, as Dell's aggressive cost-cutting in its manufacturing operations to boost its reported profits in the short term had badly weakened Dell's quality control procedures and standards for component parts, *i.e.*, batteries and finished goods, such that Dell was encountering an upsurge in customer complaints due to faulty products, including capacitor failures, motherboard failures and widespread laptop (lithium) battery defects.

(c) Dell did not have an unrivaled ability to create products or technologies that met or exceeded customer expectations, nor did it have world-class manufacturing excellence, producing high-quality products. In fact, as a result of the aggressive cost cuts in Dell's manufacturing operations, Dell's quality assurance procedures had become badly impaired, leading to a marked decline in product quality.

(d) Dell's cost-cutting program was resulting in a marked increase in the production of defective products which did not meet Dell's historic quality standards and a marked decline in Dell's historic levels of customer support and service and thus customer satisfaction, which Dell insiders knew would cost hundreds of millions, if not billions, of dollars to remedy, including the hiring of thousands of additional full-time employees to be trained to staff customer call centers and to improve Dell's quality assurance techniques and practices in its manufacturing operations.

(e) In order to cut operating costs, Dell had sharply curtailed its quality control processes by no longer testing component parts (specifically batteries, hard drives, optical drives or motherboards and laptop accessory parts, including power adaptors) received from suppliers. Rather, Dell was relying on post-assembly quick tests of completed units to discover defective component parts. In addition, it had also curtailed the post-assembly "burn-in" testing of units, which steps in combination were resulting in Dell shipping much larger numbers of computers with defects and performance problems, leading to increased quality problems and customer dissatisfaction.

(f) Dell was not providing superior customer service and support as, due to overly aggressive cost-cutting activities in Dell's customer support and service operations to boost its reported profits in the short term, including moving most of Dell's consumer and small business customer support and service call centers to India and the Philippines and replacing full-

time, well-trained employees with part-time, ill-trained (but cheaper) employees, Dell's customer support and service operations were badly impaired, resulting in very long wait times and an inability to adequately respond to customer complaints and questions, generating an upsurge in customer anger and dissatisfaction with Dell, its products and its customer support and service which Dell's internal metrics showed would hurt sales.

(g) Because of its shifting of much of its customer support and service operations, especially for its consumer and small business customers, to "call centers" in India and the Philippines and staffing its call centers with part-time, poorly trained employees, Dell was no longer providing a superior customer experience or generating high degrees of (or improving) customer satisfaction. Rather, Dell was encountering a widespread customer revolt with a massive upsurge in complaints regarding declining product quality and declining service and support operations and a sharp decline in one of Dell's key internal metrics – the "likely to repurchase" number.

(h) The Dell Direct model also was not functioning effectively with respect to Dell's direct sales process because Dell had flooded the market with a huge number of confusing and contradictory promotional offers which its now ill-trained and inadequate sales force was unable to effectively process. This was leading to refusals to honor many "coupons" and "promotions," resulting in customer dissatisfaction and refusal to buy Dell products, which was showing up in an important internal Dell metric known as the "likely to repurchase" number, where Dell was seeing soaring negative sentiment which meant customers were displeased with the Dell sales process and thus Dell's sales growth would decline.

(i) While Dell publicly disseminated favorable surveys and reports purporting to show a high degree of Dell customer satisfaction with product quality and service and support, in fact, its own internal surveys, information and customer metrics (which it constantly

monitored) showed a huge upsurge in customer dissatisfaction with and anger at Dell, including a measurable increase in negative responses to its most important metric, the so-called "likely to repurchase" number, which Dell knew indicated serious problems with ongoing sales growth.

(j) Dell's increasing product quality was not resulting in a decrease in Dell's warranty costs. In fact, Dell had quietly curtailed the length of its product warranty and sharply curtailed the breadth of its warranty coverage (it had eliminated the computer operating system from its warranty) and, in addition, had secretly adopted a new "fix-on-fail-only" policy, whereby it would provide in-home repair service or product replacement only when a computer (or component) completely failed, as opposed to merely malfunctioned, to cut costs. However, these severe restrictions in Dell's warranty and service to its customers – which was much different than Dell's historic "customer friendly" approach to warranty, service and product quality issues – were causing an upsurge in customer dissatisfaction with and anger at Dell, which Dell insiders knew would inevitably result in declining sales growth and a massive increase in warranty and product repair costs to try to restore customers' satisfaction to acceptable levels.

(k) Dell's F05 and 1stQ F06 financial results and statements were artificially inflated and falsified, as detailed in ¶¶233-273, due to a failure to properly accrue required amounts for warranty costs, failure to recognize material product defect/recall costs and failure to properly disclose the existence, nature and extent of the huge rebate payments Dell was receiving each quarter from Intel.

(l) Dell's Sarbanes-Oxley representations were false, as Dell's internal financial and accounting and disclosure controls were deficient and an undisclosed material fraud was ongoing at Dell – Dell's financial statements were being falsified, its disclosures in its SEC

filings were false and misleading and an ongoing fraudulent violation of the securities laws was occurring.

(m) Dell's statements regarding its ability to quickly benefit financially from declines in component part prices was false and misleading. The true reason for Dell's reported superior operating margins was, in large part, the hundreds of millions of dollars of secret and likely illegal rebate/kickback payments Dell was receiving from Intel at the end of each quarter in return for purchasing 100% or virtually 100% of its microprocessor requirements from Intel.

(n) Due to customer demand for PCs with the advanced features and advantages of the new AMD microprocessor chips, Dell had decided it would have to begin to purchase AMD chips for its computers, which would mean the loss of those hundreds of millions of dollars of rebate/kickback payments from Intel, which would hurt Dell's operating profits and margins.

(o) Dell's U.S. consumer/small business operations were not "going gangbusters," or achieving success, but, in fact, were performing very poorly and well below expectations due, in large part, to the product quality and customer service and support deficiencies outlined above.

(p) The Dell Direct business model was not advantaged in all environments across all regions and in all product categories or able to cause Dell to report solid profits and rapid growth regardless of prevailing market conditions due to product quality and customer service and support issues due to the deficiencies and defects detailed above.

(q) The Dell Direct model did not tend to strengthen in slower growth environments or thrive even in periods of slower component price declines or show strength when demand slowed because of the product quality and customer service and support deficiencies outlined above.

(r) Dell's purported improvements in reducing its operating expenses as a percentage of net revenues and the reported increases in its net and gross operating profit margins to record high levels were only being achieved at the cost of the serious product quality and customer support and service problems outlined above and which the Dell Defendants knew would require massive expenditures to fix, harming Dell's profitability going forward.

(s) Due to the material adverse facts and problems set forth above, Dell and the Dell Defendants knew that Dell could not and would not achieve the revenue, operating profit, operating profit margins, net income and EPS growth being forecast by them.

134. On 6/6/05, Bear Stearns reported on a dinner with Dell CEO Rollins, repeating what he had said:

Dell Inc. – Outperform
Upbeat About Growth Prospects In Good Times And Bad;
Maintaining Estimates And Outperform Rating

* * *

We hosted a dinner with Dell CEO Kevin Rollins on the eve of Bear Stearns 16th Annual Tech Conference . . . . Rollins highlighted Dell's growth capabilities in all markets, indicating its advantages tend to strengthen in slower growth environments . . . .

* * *

Rollins noted that he almost cheers when demand slows as Dell's strengths become accentuated . . . .

135. On Friday, 6/17/05, Dell traded as high as $41.22. On Tuesday, 6/21/05, the following complaint about Dell was posted on a Blog called BuzzMachine by one Jeff Jarvis:

Dell lies, Dell sucks.

Dell lies. Dell sucks.

I just got a new Dell laptop and paid a fortune for the four-year, in-home service. The machine is a lemon and the services is a lie. I'm having all kinds of trouble with the hardware: overheats, network doesn't work, maxes out on CPU usage. It's a lemon. But what really irks me is that they say if they sent someone to my home – which I paid for – he wouldn't have the parts, so I might as well just send